130 FERC ¶ 61,043
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
and John R. Norris.

Transcontinental Gas Pipe Line Corporation — Docket Nos. RP06-569-000
RP07-376-000
(consolidated)

Opinion No. 507

ORDER ON INITIAL DECISION

(Issued January 21, 2010)

1. This order addresses exceptions to an Initial Decision[1] concerning the rates charged by Transcontinental Gas Pipe Line Corporation (Transco) for storage service at its Washington Storage Field in Louisiana. While Transco originally provided only an individually certificated non-open access service at that storage field pursuant to its Rate Schedule WSS, it now also offers an open access Part 284 service under Rate Schedule WSS-OA, and most of its historic WSS customers have converted to the open access service. At issue in this proceeding is the appropriate allocation of Transco's cost of purchasing base gas[2] between historic and new customers taking service under Rate Schedule WSS-OA. The Administrative Law Judge (ALJ) rejected Transco's proposal to allocate the costs of purchasing new base gas solely to new customers, holding that those costs should be shared equally between the historic and new customers. In this order, the Commission reverses the ALJ's Initial Decision.

[1] *Transcontinental Gas Pipe Line Corp.*, 125 FERC ¶ 63,020 (2008).

[2] A base gas requirement is gas needed in storage to pressurize the reservoir to support top gas entitlements.

I. Background

A. History of the WSS/WSS-OA Rate Schedules

2. Transco's Washington Storage Service had its origins in the mid-1970s, well before the Commission initiated its open access transportation program with the issuance of Order No. 436 in 1985.[3] On February 26, 1975, the Commission approved a settlement proposed by Transco and issued a certificate to provide individually certificated contract storage service at the Washington Storage Field under Rate Schedule WSS.[4] At that time, Transco faced severe supply problems, and its curtailment of service to its high priority industrial customers had "reached extraordinary proportions."[5] The Commission found that development of the Washington Storage Field was the best available means of providing extra volumes of gas during the winter heating season.

3. As part of the settlement, Transco's customers desiring WSS service agreed to provide the base gas volumes necessary for the operation of the storage field.[6] The settlement provided that the participating sales customers would nominate base gas volumes from volumes that would otherwise be available to them for purchase under Transco's then existing bundled firm sales rate schedules. The customers' firm entitlements to purchase gas were temporarily reduced, coupled with a credit to their sales reservation charges. Transco injected the volumes into the Washington Storage Field as base gas, with Transco incurring the gas purchase cost and holding title to the gas.[7] In addition, the settlement provided that the customers would have the right to

[3] *Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 436, FERC Stats. & Regs. ¶ 30,665 (1985).

[4] *Transcontinental Gas Pipe Line Corporation*, 53 FPC 628 (1975). Amendments to Rate Schedule WSS were subsequently authorized by the following orders: 56 FPC 1351 (1976); 58 FPC 1960 (1977); 1 FERC ¶ 61,172 (1977); 4 FERC ¶ 61,271 (1978); 6 FERC ¶ 61,232 (1979); 11 FERC ¶ 62,003 (1980); 12 FERC¶ 62,287 (1980); 16 FERC ¶ 62,212 (1981).

[5] *Transco*, 53 FPC at 631.

[6] *Id.* at 630; *See also, Transcontinental Gas Pipe Line Corporation*, 87 FERC ¶ 61,184, at 61,704 (1999).

[7] Ex. T-3 at 3.

purchase their respective share of the base gas at historical cost from Transco at the time the customer terminated service from the field.[8]

4. After its Order No. 636 restructuring proceeding, Transco continued to provide only an individually certificated, non-open access service at its Washington Storage Field until 1998. On September 1, 1998, Transco filed tariff sheets to implement a new Rate Schedule WSS-Open Access (WSS-OA) to accommodate requests by shippers to convert from existing Rate Schedule WSS firm storage service to open access service under Transco's blanket certificate and Part 284 of the Commission's regulations.

5. On October 28, 1998, the Commission approved Transco's proposed Rate Schedule WSS-OA, subject to conditions.[9] The conditions were, in pertinent part, that Transco revise proposed section 8.1 of its WSS-OA rate schedule to clarify whether new replacement customers were required to provide replenishment base gas and that Transco list in its WSS/WSS-OA tariff the specific volume of base gas that each existing customer converting from Rate Schedule WSS would have a right to repurchase.

6. On November 30, 1998, Transco refiled its tariff in compliance with the Commission's directives. Transco clarified that the right to repurchase base gas upon termination of service was limited to its historic WSS customers, and new WSS-OA customers would not be required to supply base gas. Consistent with this intent, the Commission required Transco to further modify the first sentence of section 8 of Rate Schedule WSS-OA to limit the right to repurchase base gas to "Buyers who are former Rate Schedule WSS customers, that have converted to service under this rate schedule."[10]

7. In order to clarify that new customers would not be required to supply base gas, the pipeline proposed amending section 8.1 of Rate Schedule WSS-OA to state: "At the time a Buyer [historic customer] exercises its right to purchase Base Gas, Seller [Transco] will be responsible for replenishment of that portion of the Base Gas in the Washington Storage Field."[11] The Commission interpreted this language to mean that Transco accepted responsibility for providing additional base gas injections if needed to

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[8] 53 FPC at 630. Ex. T-3 at 3-4. This base gas arrangement was listed in section 9.1 and section 9.5 of Transco's then existing WSS tariff on file with the Commission.

[9] *Transcontinental Gas Pipe Line Corp.*, 85 FERC ¶ 61,119 (1998), *order on reh'g*. 87 FERC ¶ 61,184 (1999).

[10] *Transco*, 87 FERC at 61,708.

[11] *Transco*, 87 FERC at 61,707.

support the entitlements of the WSS/WSS-OA customers. The Commission, however, did not consider Transco's language to be explicit enough and accordingly, Transco was ordered to modify its proposed tariff language. Specifically, the Commission stated that:

> Transco has an ongoing obligation to provide base gas sufficient to support the top gas entitlements of its customers under these rate schedules. But, Transco does not have an obligation to provide base gas if it is not necessary to support top gas entitlements of its customers. Therefore, simply because a former Rate Schedule WSS customer has terminated service and repurchased excess base gas under its rights grandfathered in that rate schedule, does not by itself trigger an obligation by Transco to inject base gas to replace or replenish the withdrawn volumes. Transco's obligation to inject base gas arises only upon the sale of the top gas capacity entitlement to a different customer.[12]

Therefore, the Commission ordered Transco to revise its tariff to provide that the pipeline is obligated to maintain sufficient base gas to support the total top gas requirements of its customers.

8. On June 14, 1999, Transco filed the revised tariff sheets in accordance with the Commission's previous directives. On July 27, 1999, the Commission approved Transco's revised tariff filing.[13]

B. Transco's Section 4 Rate Filing

9. Prior to this proceeding, three of Transco's historic customers, PSEG Energy Resources and Trade (PSEG), Columbia Gas of Virginia (Columbia VA), and South Jersey Gas Company (South Jersey Gas) permanently released their storage service rights under Rate Schedule WSS-OA to Fortis Energy Marketing & Trading GP (Fortis) (at the time Cinergy Marketing & Trading, LP), Entergy-Koch Trading LP (Entergy-Koch), and South Jersey Resources Group, LLC (South Jersey), an affiliate of South Jersey Gas. At the same time, the three historic customers exercised their right under Rate Schedule WSS-OA to purchase their respective shares of Washington Storage Field base gas. The historic customers purchased approximately 3.4 million Dth of base gas from the Washington Storage Field. At the time of the sale, the historic storage service customers each paid the purchase price of approximately $0.89 per Dth for the base gas; however, the market price of natural gas at the time was approximately $6.00 per Dth, or

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[12] *Id*. at 61,707-61,708.

[13] *Transcontinental Gas Pipe Line Corp.*, Docket No. RP98-394-003 (July 27, 1999) (unpublished letter order).

significantly higher than the historic rate afforded to South Jersey Gas, Columbia VA, and PSEG.

10. Because Transco's WSS and WSS-OA rate schedules require that Transco maintain sufficient base gas quantities to support the total top gas capacity entitlements of its customers, Transco purchased approximately 3.4 million Dth of replacement gas for the Washington Storage Field. At the time of purchase, gas prices were significantly higher than the price of the original injected base gas; therefore, the higher cost of the newly injected base gas increased the value of the rate base of the Washington Storage service, which in turn increased the return and taxes included in the cost of service.

11. On August 31, 2006, Transco filed a general rate case under Natural Gas Act (NGA) section 4. In its filing, Transco proposed to establish bifurcated rates for its historic WSS-OA shippers and its new shippers, including Fortis, Entergy-Koch, and South Jersey. It proposed to include the costs of the newly purchased base gas solely in the rate base used to calculate the three new shippers' rates, while the rate base used to calculate the historic shippers' rates continued to include only the lower cost base gas they had previously supplied to Transco before their conversion to open access service. Transco contended that the replenishment base gas was purchased on behalf of the new shippers, and therefore the costs associated with the newly purchased base gas should be allocated solely to the new shippers. Several parties intervened either protesting or supporting Transco's proposed bifurcated rates. On September 29, 2006, the Commission accepted and suspended Transco's tariff sheets to be effective March 1, 2007, subject to refund, conditions, and the outcome of the hearing established by the order.[14]

12. On November 28, 2007, the parties filed an uncontested Stipulation and Agreement of Settlement (Settlement Agreement) of the Docket No. RP06-569-000 rate case and another proceeding not at issue here. The settlement resolved all issues in the section 4 rate case, except for one reserved issue. The settling parties agreed, *inter alia*, in Article VII of the settlement agreement to reserve for resolution pursuant to hearing or further settlement the issue of Transco's proposal under NGA section 4 to establish bifurcated rates under Rate Schedule WSS-OA to recover Transco's cost of purchasing replenishment base gas. The settling parties further agreed to treat Entergy-Koch (whose interest was later transferred to Merrill Lynch) as a historic ratepayer under Rate Schedule WSS-OA. Finally, in remarks accompanying the agreement, Transco explained that proposed section 8.3 of Rate Schedule WSS-OA was being modified to provide that Transco would be allowed to submit a limited NGA section 4 rate case to recover *only from new buyers* any increase in the cost of service attributable to the replenishment of

[14] *Transcontinental Gas Pipe Line Corp*., 116 FERC ¶ 61,314 (2006).

base gas to serve them when they contract for vacated capacity through a termination or a permanent capacity release by a terminating buyer.

13. The agreement was certified to the Commission for approval by the presiding ALJ on January 9, 2008. In the ALJ's certification of the Settlement Agreement to the Commission, the ALJ asserted that the sole issue remaining for consideration was Transco's proposal under NGA section 4 to establish bifurcated rates under Rate Schedule WSS-OA to Cinergy Marketing & Trading (and its successor Fortis) and South Jersey to recover Transco's cost of purchasing replenishment base gas. On March 7, 2008, the Commission approved the agreement to become effective as proposed.[15]

14. Regarding the litigation of the reserved issue, the participants to the proceeding filed a stipulation. The stipulation provided that: 1) parties will base their testimony and exhibits on the fixed cost component ($19.2 million) of the total Rate Schedules WSS/WSS-OA cost of service shown in Appendix B, Statement I, Exhibit No. T-1, page 30 of Transco's March 9, 2007 Compliance Filing; 2) Transco's restated direct testimony on the reserved issue will include an attached schedule reflecting its proposal, except that the incremental base gas purchases attributable to Merrill Lynch and the associated billing determinants will be treated on a non-incremental basis; and 3) any compliance filing made by Transco to implement the outcome of the litigation of the reserved issue will be based on the WSS cost of service underlying the agreement.

15. In addition to the one reserved issue regarding incremental rates, Fortis and South Jersey raised in their prepared direct testimony the issue whether the base gas purchase option should be eliminated or whether the future sale of base gas should be deferred until abandonment is approved by the Commission.[16] Several of the parties to the proceeding filed motions to strike and objected to the testimony and issues as being outside the scope of the parties' settlement. On May 19, 2008, the ALJ denied the motions and stated that he would reconsider the matter after parties have further delineated the issues in the proceeding.[17] On June 24, 2008, Transco filed, among other things, a joint statement delineating the issues for consideration at trial. These issues were:

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[15] *Transcontinental Gas Pipe Line Corp*., 122 FERC ¶ 61,213 (2008).

[16] Fortis and South Jersey, April 10, 2008, Prepared Direct Testimony, Jones at 4.

[17] Docket Nos. RP06-569-000 and RP07-367-000, Administrative Law Judge, *Order Denying Motions to Strike* at 2 (May 19, 2008).

(A) Whether Transco's proposal under section 4 of the NGA to establish incremental rates under its Rate Schedule WSS-OA to be applicable to Fortis and South Jersey to recover Transco's cost of purchasing replenishment base gas is just and reasonable.

(B) Whether Fortis and South Jersey have established that the existing base gas purchase option under section 8.2 of Transco's Rate Schedule WSS-OA is unjust and unreasonable.

(C) In the event that Fortis/South Jersey have carried their burden of proof regarding this issue, whether Fortis/South Jersey have demonstrated that their alternative proposal either to eliminate the existing base gas purchase options under Rate Schedule WSS-OA or to make the purchase options exercisable only if Transco has proposed and the Commission has approved a reduction to Transco's WSS-OA capacity as just and reasonable.[18]

16. A one-day hearing on the one reserved issue and two additional issues was held on July 10, 2008 in which Transco, WSS Customer Group, Commission Staff, and the New York Public Service Commission (NYPSC) participated. Parties filed initial briefs on August 21, 2008, and reply briefs were filed on September 12, 2008. On November 21, 2008, the Presiding ALJ issued an Initial Decision and certified the decision to the Commission.

17. On December 22, 2008, Fortis and South Jersey, Transco, WSS Customer Group, and Commission Staff filed exceptions to the ALJ's Initial Decision. On January 12, 2009, Fortis and South Jersey, Transco, and WSS Customer Group filed briefs opposing exceptions and on that same day, Transco Municipal Group (TMG) and the Municipal Gas Authority of Georgia (Municipal Gas) filed a brief on exceptions adopting certain exceptions filed by several parties to the proceeding.[19]

II. Discussion

Issue A: *Whether Transco's proposal under NGA section 4 to establish incremental rates under Rate Schedule WSS-OA applicable*

[18] *See* Transco, June 24, 2008, Joint Statement of Issues and Witness and Exhibit Lists at 2-4 (discussing the issues to be discussed at trial).

[19] Specifically, TMG and Municipal Gas adopted: 1) exception nos. 1-3 filed by the WSS Customer Group; 2) exception nos. 1-2 filed by Transco; and 3) exception nos. 1-7 filed by Commission Staff.

to Fortis and South Jersey to recover Transco's cost of purchasing replenishment base gas is just and reasonable and not unduly discriminatory or preferential.

18. Under the statutory scheme set forth in the NGA, the pipeline has the initiative through a section 4 filing to propose how it will recover its costs.[20] As the Commission has stated, "The courts have long recognized that there is no single just and reasonable rate but instead that various rates may be just and reasonable."[21] If the pipeline satisfies its burden under section 4 to show that its proposed rates are just and reasonable, the Commission must accept those rates, regardless of whether other just and reasonable rates may exist.[22]

19. As set forth more fully below, the Commission reverses the ALJ's determination that Transco's bifurcated rate proposal is not a just and reasonable method to allocate costs for the replenishment of base gas at the Washington Storage Field. The Commission further determines that Transco's rate proposal is not unduly discriminatory to replacement shippers of the Washington Storage Field because the replacement shippers and historic shippers are not similarly situated.

A. Cost Causation Principle

20. The parties have focused their contentions concerning the justness and reasonableness of Transco's proposed bifurcated rates on whether those rates are consistent with the "cost causation" principle. As the United States Court of Appeals for the District of Columbia Circuit has stated, "it has been traditionally required that all approved rates reflect to some degree the costs actually caused by the customer who must pay [for] them."[23] Further, the courts have stated that "it has come to be well established that . . . rates should be based on the costs of providing service to the utility's customers."[24] Compliance with this principle is evaluated by "comparing the costs

[20] *ANR Pipeline Co. v. FERC*, 771 F.2d 507, 513 (D.C. Cir. 1985).

[21] *Tennessee Gas Pipeline Co*., 80 FERC ¶ 61,070, at 61,223-4 (1997) (Opinion No. 406-A), *aff'd, Consolidated Edison Co. v. FERC,* 165 F.3d 992, (D.C. Cir. 1999). *See also Cities of Bethany v. FERC*, 727 F.2d 1131, 1138 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 917 (Cities); *Alabama Electric Cooperative, Inc. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982).

[22] *Western Resources, Inc. v. FERC*, 9 F.3d 1568, 1578-1579 (D.C. Cir. 1993).

[23] *KN Energy, Inc. v. FERC*, 968 F.2d 1295, 1300 (D.C. Cir. 1992) (KN Energy).

[24] *Id*. at 1300.

assessed against a party to the burdens imposed or the benefits drawn by that party."[25] However, the cost causation principle does not require a "ratemaking agency to allocate costs with exacting precision."[26]

1. Position of the Parties

21. During the hearing phase, Transco and the WSS Customer Group argued that Fortis and South Jersey should pay rates based on the full cost of the replenishment base gas, rather than lower rates based upon a roll-in of that cost with the historic cost of all base gas in the Washington Storage Field. Transco and WSS Customer Group asserted that Fortis and South Jersey should pay more because the succession of Fortis and South Jersey to the delivery entitlements of PSEG and South Jersey Gas caused the need for replenishment gas, whereas the service of all other WSS customers did not change.

22. Fortis and South Jersey contended that they should not be singled out and should pay rolled-in rates along with the other WSS customers because the purchase of the replacement base gas benefitted all customers. Fortis and South Jersey further argued that Transco never imposed such incremental rates for replacement base gas before, and instead charged such customers rolled-in rates whenever replacement gas was purchased.

23. Commission Staff asserted that the ALJ should approve its alternative, a part roll-in, part incremental rate for the WSS customers based on an estimate of the amount of replacement gas that Transco would need to inject into the field to support the existing customers' top gas deliverability needs if Fortis and South Jersey had not become replacement customers. Specifically, Commission Staff argued and presented evidence that 1.3 million Mcf of base gas should be attributed to the historic customers and should be paid for by them at Transco's replenishment cost while the remainder or approximately 2.1 million Dth, should be attributed and paid for by South Jersey and Fortis at Transco's replenishment cost. Commission Staff contended that its figures are based on Transco's own engineering calculation that approximately 1.3 million Mcf of gas would be needed to support the top gas deliverability requirements of the WSS/WSS-OA existing customers.

24. The ALJ ruled that since all base gas as a whole serves the top gas capacity and deliverability needs of all customers as a whole, it is impossible to attribute a portion of base gas to any customer in any way other than *pro rata* according to each customer's top gas volume. The ALJ stated that because no WSS/WSS-OA customer imposes more

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[25] *Midwest ISO Transmission Owners*, v. *FERC*, 373 F.3d 1361, 1369 (D.C. Cir. 2004) (Midwest ISO); s*ee also KN Energy*, 968 F.2d at 1300-1301.

[26] *Midwest ISO*, 373 F.3d at 1369.

burdens or receives any more benefits from base gas than any other customer, the principle of cost causation does not support the imposition of an incremental price on new customers based solely on the injection or withdrawal of any given quantity of gas. Moreover, the ALJ contended that the base gas value of the remaining WSS/WSS-OA historic customers is not diminished by the establishment of rolled-in rates for all Washington Storage Field customers. The ALJ further opined that Transco replenished its base gas after PSEG and South Jersey Gas withdrew their respective base gas entitlements because Transco needed to support the top gas capacity and deliverability needs of all customers even if Fortis and South Jersey had not signed on as replacement shippers. Accordingly, the ALJ ruled that the principle of cost causation supports the imposition of rolled-in rates for the replenishment of the base gas for all customers receiving service from Transco's Washington Storage Field.

25. Transco filed an exception stating that the ALJ fails to abide by the principle of cost causation and relevant Commission precedent; therefore, the decision should be reversed by the Commission. Transco argues that the ALJ's mistaken conclusion is based on the use of the base gas in the operation of the Washington Storage Field, rather than the facts of this case. Transco asserts that the ALJ's analysis is inconsistent with previous determinations by the Commission that the integrated operation of a pipeline's facilities is not determinative of cost responsibility.[27] Transco avows the ALJ errs by accepting the argument that there is at least a measurable portion of the replacement base gas purchased by Transco that, even in the absence of Fortis and South Jersey, would have been necessary to inject into the Washington Storage Field to service Transco's remaining customers. Specifically, Transco asserts that PSEG and South Jersey Gas exercised their option to purchase approximately 3.3 million Dth of gas, thereby necessitating Transco's purchase of 3.3 million Dth of replacement gas to accommodate their two replacement shippers, Fortis and South Jersey. Transco claims that Fortis and South Jersey contracted for the identical service terminated by PSEG and South Jersey Gas, respectively.

26. Transco also maintains that the relationship between the level of base gas and the deliverability capability at the storage field is not linear; its remaining customers could have elected to lower their top gas deliverability entitlements, which would have obviated the need to purchase the additional base gas.

27. The WSS Customer Group also filed an exception, stating the ALJ's analysis of Transco's incremental rate proposal is premised almost exclusively on the false proposition that because all base gas is fungible and supports deliverability on an undivided basis, all WSS-OA customers are similarly situated and must pay equal rates.

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[27] *See Transcontinental Gas Pipe Line Corp*., 106 FERC ¶ 61,299 (2004).

The WSS Customer Group states that this proposition ignores that Fortis and South Jersey are not similarly situated to the historic customers because the historic customers provided the gas to supply the original base gas to the field by: (1) giving up delivery entitlements; and (2) paying the return and tax costs associated with the customer's allocable portion of that base gas for many years. Moreover, the WSS Customer Group contends that Fortis and South Jersey are replacement shippers and as such, the effect of the ALJ's decision is to shift the proportional share of base gas responsibility allocable to Fortis's and South Jersey's delivery entitlements to all WSS/WSS-OA customers. The WSS Customer Group maintains that this is not the correct application of the cost causation standard; indeed, it is precisely the opposite because the actual operational costs of storing gas for and delivering gas to Fortis and South Jersey are higher due to the higher costs of the replacement gas.

28. Commission Staff filed an exception to the ALJ's ruling on cost causation, arguing that the Judge incorrectly found that the cost causation principle does not support the imposition of any incremental price on new customers because no WSS-OA customer receives any more benefit from or imposes any more burden on base gas that any other customer. Commission Staff states this incorrect view led the ALJ to roll-in the base gas costs while citing no record evidence for his conclusion that new and existing storage customers receive the exact same benefit from all base gas injections. Staff argues that during the hearing it proposed an alternative split which more fairly allocated the costs of Transco's replenishment of the base gas at the Washington Storage Field. But, Staff contends the ALJ did not give sufficient consideration to its evidence, which is based on the correct application of the cost causation principle and a fair allocation of the base gas replenishment costs. Consequently, Commission Staff requests that the Commission reverse this decision and adopt its cost allocation proposal.

29. Fortis and South Jersey filed a brief opposing exceptions, arguing that the ALJ correctly determined, based on substantial evidence in the record, that Transco's proposed incremental rate for Fortis and South Jersey would amount to an unreasonable allocation of costs necessary to serve the whole. Fortis and South Jersey aver that the ALJ was not incorrect in rejecting Commission Staff's hybrid incremental/rolled-in proposal because the ALJ correctly opined in the Initial Decision that the base gas serves all customers of the Washington Storage Field and all customers must be responsible for its replenishment. Fortis and South Jersey also assert that whether their actions caused or necessitated Transco's base gas purchase is, as the ALJ found, irrelevant and therefore, the ALJ's rolled-in rate decision should be affirmed by the Commission.

30. Transco and WSS Customer Group filed separate briefs opposing exceptions, arguing that Commission Staff's partial rate roll-in would involve a disproportional reallocation of base gas responsibility among WSS-OA shippers on the basis of incomplete cost analysis and hypothetical facts. Specifically, Transco and the WSS Customer Group state that Commission Staff's partial rolled-in rate proposal ignores

Transco's statements that it cannot calculate the amount of base gas capacity needed to support WSS/WSS-OA deliverability until it knows what total top gas capacity and deliverability rights must be supported. Further, they state that staff's analysis is based on the premise that there were no replacement shippers and in this case, Fortis and South Jersey were replacement shippers. Transco and the WSS Customer Group also assert that staff's proposal wrongly assumes that the service of existing WSS/WSS-OA customers has improved as a result of the replenishment of base gas at the storage field. Finally, Transco and WSS Customer Group state the Commission should affirm the Initial Decision's rejection of the partial roll-in proposal for the same reason that it should reject the decision's adoption of a complete roll-in proposal because both proposals are not supported by the record of this proceeding.

2. Commission Decision

31. The Commission reverses the ALJ ruling that the principle of cost causation does not support the imposition of incremental rates for the replenishment of the base gas on new customers receiving service from Transco's Washington Storage Field. It appears the ALJ based his analysis on the premise that, since all base gas serves the top gas deliverability and capacity needs of all WSS/WSS-OA customers as a whole, it is not possible to attribute any portion of base gas to any customers other than *pro rata* according to each customer's top gas volume.[28] Therefore, the ALJ's ruling is based on the use of base gas once it is injected in the storage field and not on the events that led to the purchase of the gas in the first instance. The fact that the interconnected nature of Transco's Washington Storage Field means that, once the replenishment base gas is in the ground, it supports the top gas needs of all customers is instructive information but not conclusive for the purpose of assigning cost responsibility. There are other factors that are more conclusive and lend support to Transco's incremental rate proposal.

32. In this case, PSEG and South Jersey Gas permanently exited Transco's Washington Storage Field with approximately 3.3 million Dth of base gas. South Jersey Gas and PSEG also contractually released their storage service rights at the field to Fortis and South Jersey. After Fortis and South Jersey became customers, Transco purchased approximately 3.3 million Dth of replacement base gas to serve their top gas capacity needs. This string of events is what caused Transco to purchase additional base gas; therefore, the imposition of costs on the new customers satisfies the principle of cost causation. If Fortis and South Jersey had not contracted for the exact same service as received by PSEG and South Jersey Gas, Transco and the existing members of the Washington Storage Field could have made other arrangements to serve their top gas

[28] The Commission also notes that the relationship between the level of base gas and the deliverability capability of a storage field is not linear.

deliverability entitlements by purchasing a smaller amount of gas or possibly reducing their top gas needs. However, this is not what happened. Fortis and South Jersey signed on as replacement shippers and as replacement shippers, it is not unreasonable that cost responsibility be assigned to them under the principle of cost causation.

33. This position is further amplified by the Commission's directives to Transco in 1999 when the WSS-OA tariff was established. Specifically, the Commission opined that the termination of service of an historic shipper does not, by itself, require Transco to replenish base gas at the Washington Storage Field.[29] Instead, the Commission stated that Transco's obligation to inject base gas into the storage field only arises when Transco resells the top gas capacity entitlement to a different customer.[30] This language shows that the Commission considered the addition of new storage customers to be an important trigger leading to Transco's purchase of replacement base gas for the Washington Storage Field. Therefore, it is entirely reasonable that the new storage customers be considered the cost causers in this instance. Moreover, replenishment of the base gas does not change or improve the service received by the historic shippers because their service level will stay exactly the same as before.

34. It is true that Transco's bifurcated rate proposal gives the historic shippers who converted from Rate Schedule WSS the entire benefit of the lower cost of the base gas injected into the Washington Storage Field before the establishment of Rate Schedule WSS-OA. However, that is reasonable, because the historic shippers helped provide that base gas. As described above, during a period of severe gas shortages in the 1970s, the historic shippers agreed to a temporary reduction in their firm purchase entitlements in order to permit Transco to take gas, which the historic shippers would otherwise have been entitled to purchase, and to inject that gas into the Washington Storage Field as base gas. The historic shippers have also been paying Transco rates which reflect a return on the cost of that base gas, together with associated taxes, ever since it was injected into the Washington Storage Field. By contrast, the new shippers did nothing to help Transco obtain the lower cost base gas previously injected into Washington Storage Field, nor have they been paying Transco rates reflecting a return on the cost of that base gas. While Rate Schedule WSS required the historic shippers to provide the base gas needed to serve them, Rate Schedule WSS-OA requires Transco to supply the base gas required to serve new shippers. In these circumstances, Transco has reasonably proposed to require the new shippers to pay rates reflecting the cost of the base gas Transco is required to supply to serve those shippers.

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[29] *See* case cited *supra* note 9.

[30] *Id.*

35. With regard to Commission Staff's proposal to allocate the costs of the new base gas between Fortis and South Jersey and the historic WSS/WSS-OA customers, the Commission determines that this is unreasonable. First, Commission Staff's partial rolled-in rate proposal is based on the hypothetical assumption that Transco would need to purchase approximately 1.3 million Mcf of base gas to support historic customers if Fortis and South Jersey had not signed on as replacement customers. However, this did not occur because Fortis and South Jersey did sign on as replacement customers and Transco purchased 3.3 million Dth of base gas to support Fortis and South Jersey's deliverability entitlements. The 3.3 million Dth gas purchase by Transco is the same quantity of base gas that PSEG and South Jersey Gas purchased upon exiting Transco's system. Finally, acceptance of Commission Staff's proposal would mean that the historic customers and replacement customers have the same status under Transco's WSS/WSS-OA tariff, and as explained more fully within this order, these customers are not similarly situated.

B. Discrimination

36. Pursuant to section 4 of the NGA, pipeline rates must not only be just and reasonable but also not unduly discriminatory.[31] A nondiscriminatory rate, however, does not mean that a rate must be the same for all customers or all customer classes. In fact, the Commission and courts have stated that a "mere difference [in rates], however, is not discriminatory; there must also be a demonstration that the two classes of customers are similarly situated for purposes of the rate." [32]

1. Position of the Parties

37. During the hearing, Transco and WSS Customer Group argued that Fortis and South Jersey were incremental shippers for whom Transco had to purchase base gas to provide service and that they were not similarly situated to the historic, non-incremental WSS customers for whom Transco did not have to incur these costs. Transco and WSS Customer Group further asserted that an incremental rate for the new shippers was not discriminatory because they are not equal to historic shippers who have contributed in the past toward the operation and maintenance of the Washington Storage Field. Commission Staff argued that an incremental rate based on the amount of gas needed to support the services of Fortis and South Jersey at the Washington Storage Field is not discriminatory because new customers have a different status from the historic shippers.

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[31] 15 U.S.C. § 717c(b) (2008).

[32] *Tennessee Gas Pipeline Co. v. FERC*, 860 F.2d 446,452, n.9 (D.C. Cir. 1988); *See also Tennessee Gas Pipeline Co.*, 80 FERC ¶ 61,070, at 61,245 (1997).

38. Fortis and South Jersey disputed the characterization of their uniqueness as customers by stating that they are "replacement" shippers, not "incremental" shippers as claimed by the other parties to the proceeding. Fortis and South Jersey also argued that Transco never attempted to impose incremental rates for replacement base gas on its replacement customers before this proceeding.

39. In the Initial Decision, the ALJ ruled that Transco's bifurcated rate proposal violated section 4 of the NGA because it was unlawfully discriminatory. Specifically, the ALJ opined that Fortis and South Jersey should be treated no differently than PSEG and South Jersey Gas because they "stepped into the shoes" of their predecessors. The ALJ contended that merely having replaced PSEG and South Jersey Gas in the same capacity is no rational basis for making Fortis and South Jersey pay more than other customers for receiving the exact same service from the exact same storage field. The ALJ asserted that this lack of a rational basis is underscored by the treatment of another replacement storage customer in the same position, Merrill Lynch. The ALJ argued that Merrill Lynch replaced Columbia VA upon its termination of WSS service and release of WSS storage capacity. The ALJ asserted that in its initial August 31, 2006 rate increase filing, Transco proposed bifurcated WSS-OA rates to recover the cost of replenishment base gas attributable to Merrill Lynch; however, in the settlement agreement, Transco accepted and agreed to rolled-in rate treatment for Merrill Lynch. While the Commission does not consider settlement agreements precedential, the ALJ stated that the treatment of Merrill Lynch is illustrative of the fact that replacement shippers who are similarly situated to Fortis and South Jersey are subject to differing treatment by Transco under its incremental rate proposal.

40. In addition, the ALJ contended that the potential for widely differing treatment of similarly situated customers is particularly true given Transco's proposed amendment to section 8.3 of the WSS-OA tariff, which permits Transco to make a limited section 4 rate filing to recover from new buyers any increase in the costs of service attributable to the replenishment of base gas to service the new buyers. The ALJ reasoned that the impact of the language would mean that Transco could arbitrarily choose to impose incremental rates on some new buyers and not others.

41. Finally, the ALJ asserted that the fact that Fortis and South Jersey did not contribute to past costs of base gas needed to operate the Washington Storage Field is equally no distinction justifying differential treatment because Fortis's and South Jersey's predecessors did contribute to these costs. The ALJ opined that Fortis and South Jersey were also at a competitive disadvantage to the historic WSS/WSS-OA customers in that they do not enjoy the right to purchase base gas at historic cost. The ALJ reasoned that this disadvantage does not justify making Fortis and South Jersey even worse off by granting Transco's incremental rate proposal.

42. Transco filed an exception arguing that the ALJ's discrimination analysis is fatally flawed, as it disregards the factual record in this proceeding and well-established Commission precedent. Transco states it is undisputed that Fortis and South Jersey are replacement shippers for whom Transco had to purchase replacement base gas in order to provide their service. As a result, Transco asserts there can be no doubt that Fortis and South Jersey are not similarly situated to the non-incremental WSS customers, for whom Transco did not have to incur the costs for replacement base gas. Transco alleges the ALJ's oversimplified "stepping into the shoes" argument is insufficient to establish that Fortis and South Jersey are similarly situated to Transco's historic customers.

43. Transco argues the ALJ's conclusion that the fact Fortis and South Jersey did not contribute to past costs of base gas is not a basis for different rate treatment is inconsistent with Commission and judicial precedent. In particular, Transco states the Commission and federal courts have previously determined that there is no undue discrimination where: 1) rate differentials were the result of private contracts, where the complaining party chose not to execute the contracts;[33] 2) a rate disparity was the result of a settlement agreement, even though there was no cost basis;[34] 3) a complainant rejected an offer to enter into a fixed-rate contract that other customers had accepted;[35] and 4) substantially lower rates were given to help retain customers that represent over 90 percent of a utility's annual revenue, but were not offered to another class of customers.[36]

44. Transco claims the ALJ also errs in his suggestion that Transco's proposed treatment of the cost of base gas purchased to replace gas sold to Columbia VA undermines its incremental rate proposal to Fortis and South Jersey. Transco avows the ALJ is trying to use a decision reached regarding Merrill Lynch as part of a settlement agreement as precedent when this is improper. Transco states that it initially proposed the same rate treatment for all three replacement shippers; however, prior to the hearing and as part of the settlement, all parties agreed to rolled-in rate treatment for the base gas used for service to Merrill Lynch. Therefore, Transco contends the ALJ is incorrect in his suggestion that the settlement agreement's proposal with regard to Merrill Lynch's rates is somehow illustrative and provides evidence that Transco's interim rate proposal is unduly discriminatory.

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[33] *See Maine Pub. Serv. Co. v. FERC*, 964 F.2d 5 (D.C. Cir. 1992), *on remand sub nom. Central Maine Power Co.*, 60 FERC ¶ 61,285 (1992).

[34] *See Cities*, 727 F.2d 1131.

[35] *See City of Frankfort v. FERC*, 678 F.2d 699, 707 (7th Cir. 1982).

[36] *See St. Michaels Utils. Comm'n. v. FPC*, 377 F.2d 912, 916 (4th Cir. 1967).

45. Finally, Transco claims the ALJ's attempts to demonstrate that the proposed tariff language to allow incremental pricing of the costs of replacement base gas in the future has the potential for arbitrarily different treatment of customers. Transco contends that the ALJ's assertion is based upon pure speculation, and bears no relevance to whether Fortis and South Jersey are similarly situated to the existing WSS-OA customers. Further, Transco states that it has a *Memphis* clause[37] in its tariff which permits the pipeline to propose unilateral rate changes, which must be deemed just and reasonable by the Commission.

46. WSS Customer Group filed an exception to the decision on discrimination arguing that the ALJ overly relies on the significance of the operational physics of the Washington Storage Field without regard to cost causation or other ratemaking principles and the utilization of a hypothetical set of facts regarding service to WSS-OA customers. WSS Customer Group argues that the ALJ's decision fails to account for the underlying facts and policies supporting Transco's NGA section 4 bifurcated rate proposal which demonstrate that it is both just and reasonable and not unduly discriminatory. WSS Customer Group states these facts include that Transco's base gas purchases at issue in this matter were directly and proximately caused by Fortis and South Jersey. WSS Customer Group further maintains that the bifurcated rate proposal is completely consistent with cost causation ratemaking principles. Finally, WSS Customer Group avers that Transco's incremental rate proposal is not unduly discriminatory because Fortis and South Jersey are similarly situated to Transco's historic WSS-OA shippers.

47. WSS Customer Group also alleges that the ALJ spends essentially no time discussing the justness and reasonableness of the Fortis and South Jersey's uniform rate proposal in the Initial Decision. Instead, WSS Customer Group asserts the ALJ treats uniform rates as the inverse of bifurcated rates and apparently concludes that if bifurcated rates are unjust and unreasonable, then uniform rates must be just and reasonable. WSS Customer Group further argues that uniform rates in this regard are unjust and unreasonable because they: 1) send the wrong price signals to the market for storage service; and 2) cause historic WSS-OA shippers to subsidize the costs of the new shippers. Finally, WSS Customer Group states that as sophisticated customers, Fortis and South Jersey knew or should have known that they would be required to bear the costs related to the replenishment of base gas at the Washington Storage Field.

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[37] A "*Memphis* clause," is named for *United Gas Pipe Line Co. v. Memphis Light, Gas and Water Div.*, 358 U.S. 103 (1958). The *Memphis* clause specified that "rates, charges, classifications and service" were subject to FERC regulation, and allows Transco to request and implement rate changes.

48. Commission Staff filed an exception to the ruling, asserting that the ALJ incorrectly found that bifurcated rates are unduly discriminatory. Commission Staff states that contrary to the ALJ's finding, Transco did have to purchase additional base gas which, in part, was specifically required to provide storage service to Fortis and South Jersey. Consequently, Commission Staff argues that Fortis and South Jersey are not similarly situated to the existing WSS/WSS-OA customers. Commission Staff contends that Fortis and South Jersey are new customers on the system and they impose additional base gas costs on Transco over and above the base gas requirements of existing customers. Commission Staff avers that it is simply wrong to hold that Fortis and South Jersey stand in the shoes of their predecessor shippers, PSEG and South Jersey Gas, when these shippers purchased back the historic base gas used to support their service upon exiting the system.

49. Furthermore, Commission Staff contends that the Merrill Lynch settlement is not precedent and certainly should not be cited as illustrative of undue discrimination as the Judge did. Commission Staff states that a settlement represents bargained for exchanges in which Merrill Lynch presumably gave up something of value to get uniform rate treatment. Moreover, Commission Staff states that Merrill Lynch is a significantly smaller storage customer than Fortis and South Jersey because Merrill Lynch only has 48,227 Dth of base gas attributable to it.

50. Fortis and South Jersey filed a brief opposing exceptions, arguing that the ALJ did not err in finding bifurcated rates unduly discriminatory and prejudicial. Fortis and South Jersey state that Transco still fails to justify why it is just and reasonable to treat similarly situated WSS customers differently when, in fact, Transco has never before done so with any other WSS or WSS-OA customer. Fortis and South Jersey also reiterated their arguments from the hearing regarding why uniform rates for all customers at the Washington Storage Field are just, reasonable, and nondiscriminatory. Therefore, Fortis and South Jersey urge the Commission to affirm the decision of the ALJ without modification.

2. Commission Decision

51. The Commission reverses the ALJ's ruling that Transco's incremental rate proposal violated section 4 of the NGA because it was unlawfully discriminatory. The Commission determines that Transco's proposal to charge different rates to Fortis, South Jersey, and other new shippers is not unduly discriminatory because Fortis and South Jersey are not similarly situated to historic shippers of the Washington Storage Field. The Commission considers the rate differential reasonable, because the historic shippers were required to provide the base gas used to serve them, whereas the new shippers do not provide base gas. As described above, during a period of severe gas shortages in the 1970s, the historic shippers agreed to a temporary reduction in their firm purchase entitlements in order to permit Transco to take gas, which the historic shippers would

otherwise have been entitled to purchase, and to inject that gas into the Washington Storage Field as base gas. Moreover, until the historic shippers' conversion to open access service, section 9.1 of Rate Schedule WSS provided:

> The Base Gas shall be provided by Buyer from quantities otherwise available under Seller's CD, G, and OG [sales] rate schedules. Each Buyer shall be informed of the quantity of Base Gas to be supplied by such Buyer for each increment of Storage Quantity.

Similarly, section 9.5 of Rate Schedule WSS gave the historic shippers a right to repurchase the base gas they had supplied, if they terminated their WSS service. In recognition of the fact the historic shippers had supplied base gas, the Commission approved Transco's proposal, when it implemented Rate Schedule WSS-OA to grandfather the historic shippers' right to repurchase their base gas, but not to give any similar right to new shippers under that rate schedule.

52. The Commission further disagrees with the ALJ's assessment that Fortis and South Jersey should not be charged a bifurcated rate because they "stepped into the shoes" of their predecessors, PSEG and South Jersey Gas.[38] Transco's WSS-OA tariff is already designed so that historic shippers and replacement shippers are not similarly situated. Historic shippers provided their own base gas and have grandfathered purchase rights enshrined in section 8.2 of Rate Schedule WSS-OA. By contrast, section 8.1 of that rate schedule requires Transco to supply the base gas needed to serve new shippers, and does not give new shippers any right to repurchase base gas when they exit the system. It was this provision that allowed Fortis and South Jersey's predecessors to exit the system and purchase base gas at historic cost. As replacement shippers, Fortis and South Jersey do not have this right.

53. With regard to the ALJ's use of Merrill Lynch receiving the same rates as the historic shipper as illustrative of a lack of rational basis for treating Fortis and South Jersey differently from other WSS-OA storage customers, the Commission does not believe that this argument has merit. First, Transco proposed bifurcated rate treatment for all the base gas purchased on behalf of the replacement shippers, including the base gas attributable to Merrill Lynch. It was only during the settlement process that the parties agreed to rolled-in treatment for the costs of replacement base gas for Merrill Lynch. The Commission does not consider it wise to use a term bargained for in a

[38] The Commission agrees with Commission Staff's assessment that it was not possible for Fortis and South Jersey to step into the shoes of their predecessors when these historic shippers purchased back the base gas used to support their service when they permanently left the system.

settlement agreement in which parties presumably gave up some rights to get others as evidence in a litigated proceeding because settlements are not precedential in any way.[39]

54. Finally, the Commission is not persuaded that Transco's proposed amendment to section 8.3 of the WSS-OA tariff will have the potential for widely different treatment of similarly situated customers. Transco's proposed amendment merely states that the pipeline will have the ability to make a limited section 4 rate filing to recover from new shippers any increase in the cost of service attributable to the replenishment of base gas to serve them. This amendment actually treats similarly situated replacement shippers exactly the same. The amendment subjects all new replacement shippers to the same requirements as other replacement shippers. As stated previously, replacement shippers and historic shippers are not similarly situated already under section 8.2 of the WSS-OA tariff and this provision helps to clarify that difference with regard to the different rate treatment.

55. Accordingly, the Commission determines that Transco's proposed bifurcated rate treatment for historic shippers and new shippers, including Fortis and South Jersey is just and reasonable and not unduly discriminatory.

C. 1999 Pricing Policy Statement

56. During the hearing, the parties referred to the Commission's *Certification of New Interstate Natural Gas Pipeline Facilities* (*1999 Pricing Policy Statement*),[40] including its three-part test to support their respective positions. The parties contended that the decision, while not directly on point, contains useful guidance for this proceeding. Specifically, the *1999 Pricing Policy Statement* was developed by the Commission to assist in determining whether natural gas pipeline expansion projects should be paid for by all gas customers or only specific gas customers using the service. The policy statement not only covers capital costs of expansion projects but also operational costs of projects; in addition, the *1999 Pricing Policy Statement* seeks to deter the subsidization by existing customers of those costs caused by new customers. As a result, the decision presumptively favors incremental rates over rolled-in rates to protect historic customers from subsidizing new customers. This presumption, like most others, is rebuttable and includes a three-part test which, if satisfied, leans toward rolled-in rates: 1) whether the

[39] *See, e.g., Transcontinental Gas Pipe Line Corp*., 122 FERC ¶ 61,213, at P 11 (2008) (Commission approval of the Settlement Agreement does not constitute approval of, or precedent regarding, any principle or issue in this proceeding.).

[40] *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227 (1999), *clarified*, 90 FERC ¶ 61,128, *further clarified*, 92 FERC ¶ 61,094 (2000) (*1999 Pricing Policy Statement*).

new facilities are needed to improve service to existing customers; 2) whether the increased rates are related to improvements in service; and 3) whether raising rates to existing customers would not constitute a subsidy to new incremental customers.

1. Position of the Parties

57. The parties differed over the first factor: whether the addition of replenishment base gas after PSEG and South Jersey Gas exercised their base gas purchase options constitutes an "improvement in service" to the existing customers such that rolled-in rates would be more appropriate than incremental rates. Fortis and South Jersey argued that the replenishment of base gas improved service to all customers because if the gas was not replenished, service to all customers would have been diminished. To Transco and the WSS Customer Group, the replenishment gas was not an improvement but merely a continuation of the existing service. Commission Staff, on the other hand, put forth a "middle ground" argument stating that a portion, but not all of, the base gas was needed to prevent a diminution in service for historic WSS-OA customers.

58. The ALJ ruled that, to the extent the *1999 Pricing Policy Statement* applies at all, it supports the imposition of rolled-in rate treatment for the replenishment of base gas at the Washington Storage Field.

59. Transco filed an exception to the ALJ's ruling, stating the Initial Decision's conclusion that *1999 Pricing Policy Statement* is of limited value because the Washington Storage Field serves all customers equally and that if anything, the decision militates toward rolled-in rates rests upon several assumptions contradicted by Commission precedent. WSS Customer Group filed an exception arguing that the ALJ's ruling the Commission's *1999 Pricing Policy Statement* supports rolled-in rates is seriously flawed.

60. Commission Staff filed an exception to the ruling stating the ALJ erroneously found that the *1999 Pricing Policy Statement*, to the extent it applies at all, favors rolled-in rates given the facts in this case, particularly the fact that all base gas supports all top gas. Commission Staff avers that the ALJ's conclusion that the first prong of the *1999 Pricing Policy Statement* is inapplicable to the facts of this proceeding is contrary to the evidence presented by Staff.

61. Fortis and South Jersey filed a brief of opposing exceptions arguing the ALJ appropriately found, to the extent the *1999 Pricing Policy Statement* applies at all, the decision weighs against Transco's incremental pricing proposal. Accordingly, Fortis and South Jersey argue the Commission should reject the arguments advanced by Transco, Commission Staff and the WSS Customer because such arguments have already been weighed by the ALJ and found deficient.

2. Commission Decision

62. The Commission determines that the *1999 Pricing Policy Statement* is inapplicable to the facts of this proceeding. Therefore, we reverse the ALJ's ruling that the *1999 Pricing Policy Statement* weighs against Transco's showing that its bifurcated rate proposal is just and reasonable. As stated previously, the purpose of the *1999 Pricing Policy Statement* was to provide the natural gas industry with guidance as to the analytical framework the Commission will use to evaluate proposals for certificating new construction.[41] The *1999 Pricing Policy Statement* established criteria for determining whether there is a need for a proposed project and whether the proposed project will serve the public interest.[42] It explains that in deciding whether to authorize the construction of major new pipeline facilities, the Commission balances the public benefits against the potential adverse consequences. The goal of the Commission is to give appropriate consideration to the enhancement of competitive transportation alternatives, the possibility of overbuilding, subsidization by existing customers, the applicant's responsibility for unsubscribed capacity, the avoidance of unnecessary disruptions of the environment, and the unneeded exercise of eminent domain in evaluating new pipeline construction.[43]

63. The *1999 Pricing Policy Statement* was never intended to be used as a tool to evaluate the proper rate treatment of a preexisting facility that has not been expanded or upgraded to provide service enhancements. In this case, there was no "construction" or "expansion" but only the replenishment of base gas at a preexisting facility. Transco's actions do not fit under the parameters of the *1999 Pricing Policy Statement* and the Commission declines to extend the application of the policy to these facts.

III. Scope of the Hearing

> **Issue B:** *Whether Fortis and South Jersey's have established that the existing base gas purchase option under section 8.2 of Transco's Rate Schedule WSS-OA is unjust and unreasonable.*
>
> **Issue C:** *In the event that Fortis/South Jersey have carried their burden of proof regarding Issue B above, whether Fortis/South Jersey have demonstrated that their alternative proposal either to eliminate the existing base gas purchase options under Rate*

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[41] *1999 Pricing Policy Statement*, 92 FERC ¶ 61,389 (2000).

[42] *See Vector Pipeline, LP*, 117 FERC ¶ 61,018, at P 9 (2006).

[43] *Id.*

Schedule WSS-OA or to make the purchase gas options exercisable only if Transco has proposed and the Commission has approved a reduction to Transco's WSS-OA capacity is just and reasonable.

64. Before addressing the merits of Issues B and C, the Commission must determine whether these issues should have been addressed by the ALJ during the proceeding or whether the issues where barred from consideration under the terms of the parties' settlement.

65. As an initial matter, the Commission notes that settlement agreements are contracts and the Commission must abide by the unambiguously expressed intent of the parties to the settlement.[44] A contract is considered ambiguous if it is "reasonably susceptible of different constructions or interpretations"[45] and not simply because parties to the contract later on disagree on the provisions.[46]

A. Position of the Parties

66. During the hearing, Transco, WSS Customer Group and NYPSC argued that Article VII of the settlement agreement reserved a single issue for hearing and that this precludes consideration of other issues. WSS Customer Group averred that a resolution of Fortis and South Jersey's section 5 proposals in this proceeding would suggest that issues reserved in a settlement agreement for subsequent disposition are not binding nor limiting on the parties to settlement. NYPSC asserted in this regard that the settlement agreement is a contract and consequently, the Commission is required to give effect to the provisions of FERC-approved settlement agreements and to the parties' unambiguously expressed intent in such provisions. NYPSC also advised the ALJ to note the absence of express language in Article VII of the settlement agreement reserving the purchase option in the tariff as an issue for litigation. Fortis and South Jersey argued that the above issues are properly before the ALJ and should be considered during the hearing because the historic purchase provision has already inflated Transco's storage rates and if left in place, the provision might result in higher rates for WSS storage customers. Commission Staff did not take a position on the above two issues and did not comment on them during the hearing.

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[44] *See Ameren Services Company v. FERC*, 330 F.3d 494, 498 (D.C. Cir. 2003) (Ameren).

[45] *Consolidated Gas Transmission Corp. v. FERC*, 771 F.2d 1536, 1544 (D.C. Cir. 1985); *see also Lee v. Flintkote Co*., 593 F.2d 1275, 1282 (D.C. Cir. 1979).

[46] *See WMATA v. Mergentime Corp*., 626 F.2d 959, 961 (D.C. Cir. 1980).

67. In the Initial Decision, the ALJ opined that, because a settlement agreement is a contract, he was obliged to construe the agreement "as a whole" giving effect to all of its terms.[47] Accordingly, the ALJ held that other provisions of the settlement agreement besides the reservations clause in Article VII make clear that other issues may be addressed in this proceeding. The ALJ noted that Article X of the settlement agreement, entitled "Reservations," states, in pertinent part:

> Neither Transco, the Commission, its Staff, nor any other party or person shall be prejudiced or bound hereby in any proceeding except as specifically provided herein. Neither Transco, the Commission, its Staff, nor any other party or person shall be deemed to have approved, accepted, agreed or consented to any concept, theory, or principle underlying or supposed to underlie any of the matters provided for herein.
>
> . . . [E]xcept as expressly provided by this Agreement, the other parties hereto [other than Transco] preserve their rights under the NGA.
>
> Except as otherwise provided by this Agreement, nothing herein is intended to limit, supersede, or otherwise affect the resolution of issues not expressly resolved hereby.

Thus, the ALJ opined that Article X of the settlement agreement proves that the parties explicitly asserted their right to have the Commission resolve the issues put forth by Fortis and South Jersey.

68. Moreover, the ALJ asserted the Commission has consistently held that presiding ALJs in hearings regarding proposed rates may incorporate issues that they find are related to the justness and reasonableness of the proposed rates. The ALJ cited the decision in *Cincinnati Gas and Electric Company* (*Cincinnati Gas*), where he states the Commission concluded that an ALJ could consider the prudence of a utility's investment in a generating station where the issue explicitly set for hearing was the justness and reasonableness of the utility's proposed rate increases.[48] The ALJ asserted the Commission in Cincinnati Gas concluded that the recovery of costs associated with the generating station related to the proposed rate increase in that case, adding that the parties had been on notice that intervenors intend to address the prudence of the costs of the generating station.[49] In that same vein, the ALJ cited *Long Island Lighting Company*, as

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[47] *See Ameren*, 330 F.3d at 498.

[48] *Citing Cincinnati Gas and Electric Co.*, 59 FERC ¶ 61,072, at 61,292 (1992) (*Cincinnati Gas*).

[49] *Id.*

another example of a case where the Commission found that a party could raise issues related to the terms and conditions of a Power Supply Agreement (PSA) even where the Commission did not explicitly state that such factors would be at issue in the order setting the hearing on the PSA.[50]

69. The ALJ asserted that hearing these issues would not interfere with the negotiation of settlements by requiring participants to formulate exhaustive lists of the issues that are precluded from further litigation. The ALJ opined that parties negotiating future settlements who wish to avoid this possibility need only say so expressly and avoid such open-ended language. Instead, the ALJ argued that it is the open-ended wording of the provisions of Article X of the agreement itself that has left open the possibility of litigating other issues here. Hence, the ALJ concluded that it would be grossly restrictive to interpret the settlement agreement as a whole to preclude an examination of the purchase option itself for justness and reasonableness, along with the justness and reasonableness of how the purchase option is paid for.

70. Transco excepts to the ALJ's consideration of the NGA section 5 proposal by Fortis and South Jersey to modify or remove the base gas purchase option for original WSS shippers from Transco's tariff. Transco states that such consideration is barred by the explicit terms of Article VII, Section A, of the parties' settlement agreement. Moreover, Transco contends that the settlement agreement expressly states that any proposed change to it may only be considered under the "public interest standard" of the *Mobile-Sierra* doctrine,[51] any modification to the agreement which allows consideration of Fortis and South Jersey's tariff revision proposal requires a demonstration that the challenged term "seriously harms the public interest." Transco states, like Fortis and South Jersey during the trial phase, the ALJ does not even attempt to demonstrate that its expansion of the settlement agreement satisfies this standard.

71. Transco argues that the ALJ incorrectly attempts to justify his consideration of the NGA section 5 challenge based on an improper interpretation of Article X, which is entitled "Reservations." Transco avers the language in Article X of the agreement clearly indicates that the parties intended that Transco's bifurcated rate proposal would be the sole issue reserved for hearing. Transco states the language in Article X combined with the fact that Article VII expressly provides that it reserves for litigation only Transco's bifurcated rate proposal proves that the parties agreed that no other issues would be litigated during the hearing. Transco also contends that if the parties had intended to

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[50] *See Long Island Lighting Company*, 83 FERC ¶ 61,076 (1998).

[51] *See FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 355 (1956); *United Gas Pipe Line Co.* v. *Mobile Gas Serv. Co.*, 350 U.S. 332 (1956).

litigate other issues as part of the proceeding, there would have been no need for Article X's restriction of the parties' rights or Article VII's express delineation of the issue to be litigated at trial.

72. Lastly, Transco claims that an affirmation of the ALJ's interpretation of Article X would deter future litigants from entering into partial settlements. Transco avers that contrary to the ALJ's proclamations otherwise, future litigants would be required to submit exhaustive lists of issues that are precluded from litigation, notwithstanding the fact that they included language identifying the only issues they had reserved for litigation. Accordingly, Transco states the Commission should overturn, as outside the scope of the single issue reserved for litigation by the settlement agreement, the portion of the Initial Decision considering Fortis and South Jersey's section 5 NGA proposal.

73. WSS Customer Group filed an exception to the ALJ's decision allowing Fortis and South Jersey's section 5 proposal to be litigated stating that neither the settlement nor the certification of the settlement contemplate the hearing of additional or supplementary section 5 issues in this proceeding. WSS Customer Group asserts that there is simply no evidence that the ability of shippers to raise section 5 issues in this proceeding was reserved as part of the settlement in this case.

74. WSS Customer Group states that Fortis and South Jersey had every opportunity to formulate section 5 issues in the prior proceeding and to ensure that these issues were reserved for hearing in this docket. WSS Customer Group argues that nowhere in the record is there evidence that they preserved their section 5 rights as part of the settlement process. WSS Customer Group asserts that in as much as the stated purpose of the settlement agreement is to resolve all issues in Transco's rate case except for the sole reserved one, it is highly inappropriate to permit additional issues to be litigated at the last minute.

75. Commission Staff excepts to the ALJ's interpretation of the settlement agreement stating that the parties to the settlement never intended that the boilerplate language of Article X would nullify the settlement provision in Article VII identifying the limited issues to be litigated. Commission Staff argues that most telling of this fact is that no party argued to the judge the settlement agreement should be read in such a manner because all parties intended to be bound by the settlement. Moreover, Commission Staff claims that the Reservations Article in the settlement is generally intended to address the parties' rights in future cases, not the present one. Consequently, Commission Staff alleges that the ALJ's view of the settlement is erroneous and Article X cannot be interpreted to allow any issue to be raised in this proceeding.

76. Fortis and South Jersey filed a brief of opposing exceptions alleging that the ALJ did not err in considering their section 5 challenge to eliminate prospectively the base gas purchase rights contained in section 8.2 of Transco's WSS-OA tariff. Fortis and South

Jersey argue that the ALJ considered Transco's contention that the settlement foreclosed discussion of Fortis and South Jersey's section 5 proposal and each time the Judge rightly rejected that contention. Fortis and South Jersey avow that the settlement simply did not foreclose consideration of their challenge and no party has now or ever cited to a specific provision in the agreement that actually prohibits Fortis and South Jersey from raising the section 5 challenge.

B. Commission Decision

77. The Commission reverses the ALJ's ruling that Article X of the Settlement Agreement, entitled "Reservations" makes unambiguously clear that the parties reserved their right to have other issues addressed in the proceeding. The Commission further determines that Issues B and C were not properly before the ALJ as they were outside the scope of the issue reserved for consideration by the parties pursuant to the Settlement Agreement and therefore, they should not have been litigated during hearing.

78. A review of Article VII of the Settlement Agreement shows that the parties intended to reserve only one issue for litigation before the Commission. Specifically, the settling parties agreed in Article VII:

> **Section A: Reserved Issue** – The parties have agreed to reserve for resolution pursuant to hearing or further settlement the issue of Transco's proposal under NGA section 4 to establish incremental rates under Rate Schedule WSS-OA to Cinergy Marketing & Trading (and its successor Fortis Energy Marketing & Trading) and South Jersey Resources Group, LLC to recover Transco's cost of purchasing replenishment base gas.

This language only reserves the issue of the reasonableness of Transco's proposal under NGA section 4 concerning its recovery of the cost of purchasing replenishment base. It makes no reference to the separate issue of whether the historic customers' existing right to purchase base gas should be modified under NGA section 5. Consistent with this fact, the ALJ stated, in his certification of the settlement to the Commission, that the parties have reserved only one issue for litigation before the Commission.

79. Although the ALJ relies on the reservations clause in Article X of the agreement as proof that the parties explicitly asserted their right to have the Commission resolve the issues put forth by Fortis and South Jersey, the Commission believes that the parties did not rely on such boilerplate language to nullify the explicit provision of Article VII binding them to litigate only one issue. The Commission notes that no party, not even Fortis and South Jersey, raised this as an argument to the ALJ in support of the consideration of Issues B and C. Moreover, this reservations clause states the parties shall not be "prejudiced or bound hereby in any proceeding except as specifically provided herein." The language of this phrase shows that the parties intended to bind

themselves to the agreements made in the context of this settlement in this proceeding but not in any other proceeding. This language does not, as the ALJ suggests, show that the parties did not intend to be bound by Article VII of the settlement.

80. Finally, the ALJ cites several cases in which the Commission allowed the consideration of other issues in addition to the issues identified at the beginning of the hearing as evidence that any issue connected to the main issue may be raised and considered at trial. The Commission believes that the cases the ALJ cited are distinguishable from the facts of this proceeding. The cases cited by the ALJ were not ones in which all the parties agreed and stipulated to the sole issue for consideration in a settlement agreement that was later approved by the Commission as being in the public interest.[52] Because the parties had settled on a single issue for trial and the Commission later approved this settlement, it is up to the Commission to honor the terms of the agreement as it would any contract.

The Commission orders:

The Initial Decision is reversed as discussed above.

By the Commission. Commissioner Norris voting present.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

[52] *Transco*, 122 FERC ¶ 61,213 at P 11.